

## Executive Summary

- The Income Tax Act, 1961 (Act) proposes imposition of penalty on an assessee, if the Assessing Officer (AO)/Commissioner of Income Tax-Appeals/Commissioner of Income Tax (CIT) is satisfied that there has been non-compliance with or violation of law and there is no reasonable cause for failure. Chapter XXII of the Act declares certain acts of omission and/or commission as punishable offences. Offences and Prosecution under the Act are read in conjunction with other laws such as Indian Penal Code (IPC), Code of Criminal Procedure (Cr PC) and Indian Evidence Act (IEA).
- The Wanchoo Committee Report of 1975 recommended that Income Tax Department (ITD) needs to evolve and pursue vigorous prosecution policies and emphasized that monetary penalties may always not be enough. The White Paper on Black Money of May 2012 by Ministry of Finance (Ministry) described that taxpayers may be willing to take a calculated risk of tax evasion and it may be more effectively deterred by effective prosecution. A committee headed by the Chairman of Central Board of Direct Taxes (CBDT) constituted in May 2011 recommended establishment of special judicial set up within the existing framework as also amendments to various fiscal statutes so that they become stronger. In response to these, ITD has also taken several efforts to streamline and strengthen the deterrent mechanisms against tax evasion in general and income tax in particular.
- As penalty and prosecution are important deterrent mechanisms, we felt it necessary to examine the administration and implementation of penalty and prosecution machinery, by the CBDT and its field formations for combating tax evasion. We sought to achieve this by examining current structures, its utilization and effectiveness. Our objective for examining penalty provisions inter alia was to whether the mechanism for administration and levy of penalties for various defaults existed and is functional and had a deterrent effect on tax evasion. In respect of prosecution, our focus was to examine the functional efficiency of the prosecution mechanism at various levels in ITD.

### Administration and Levy of Penalty

- We studied the initiation and levy of penalty across all the States in audit during August 2012 and December 2012. We found that the ITD delayed in completion of penalty proceedings which led to potential loss of revenue (*paragraph 2.3*). ITD did not apply penalty as per provisions of the Act in cases such as (a) non-complying with filing requirements covering Income Tax Returns, Tax Audit Reports, Books of Accounts; (b) concealment

of income and (c) failure to provide return for TDS/TCS (*paragraphs 2.12, 2.14 and 2.15*). ITD did not apply penalty provisions for cash transaction which led to tax effect of ₹ 56.60 crore (*paragraph 2.16*). We also found that the Act is silent on time-limit for initiation of penalties though it provides time-limit for completion of penalty proceedings (*paragraph 2.8*).

### **Administration of Prosecution**

- We attempted to study the mechanism of prosecution as measured by the functional efficiency at various levels *vis-a-vis* roles and responsibilities fixed at various levels. Since prosecution was enforceable at the instance of the Court, the interplay with the judicial machinery was also part of our study.
- Our study revealed mismatches at every stage of selection, initiation, pursuance and disposal of cases as also at every level of monitoring and coordination. To handle prosecution cases, CBDT has not ensured posting of appropriate officers as Nodal Officers in its field formations (*paragraph 3.2.1*). There are discrepancies in figures of pending cases as reported by Officer in-charge (Prosecution) to CBDT questioning the authenticity and reliability of prosecution data (*paragraph 3.2.3*). ITD has not performed physical verification of prosecution records since FY 08 streamlining the record maintenance (*paragraph 3.2.4*). Nodal Officers have not maintained the prosecution registers despite various instructions issued by CBDT (*paragraph 3.2.5*). ITD has not given adequate priority in launching of prosecution as indicated by delay in initiation of cases and by not launching the prosecution even in approved cases (*paragraph 3.3*).
- Prosecution cases are being pursued on companies which have already been liquidated or have been declared sick by BIFR (*paragraphs 3.4.6 and 3.4.7*). CBDT is wasting resources in pursuing cases under repealed sections of the Act, dead assessee etc. (*paragraph 3.4.3*). CBDT did not utilize the prosecution mechanism for ensuring tax compliance under section 276CC of the Act (*paragraph 3.4.5*).
- We found that ITD's nominees are not attending regular hearing in the Courts impacting disposal of cases (*paragraph 3.5.2*). ITD has poor records maintenance and inadequate monitoring of prosecution cases pending in the Courts (*paragraph 3.5.3*). Poor record maintenance and delay in timely production of evidences has led to acquittal of assessee in prosecution related offences (*paragraph 3.6*). The enforcement of CBDT's policy and procedures on Prosecution Counsels has not been effective and has impacted the pursuance of cases (*paragraph 3.7*).

- ITD did not use the compounding of offences as alternate dispute resolution mechanism effectively to reduce the litigation and realize the due revenue (*paragraph 3.9*). ITD has acted not in consonance with the spirit of National Litigation Policy by wasting prosecution machinery on technical offences (*paragraph 3.10*). Prosecution machinery of ITD was used to handle individual assesseees and low money value cases, not against systematically organized entities (*paragraph 3.11*). Central Economic Intelligence Bureau established for gathering, collation and dissemination of information among tax gathering agencies like CBDT, CBEC etc. has not worked in coordinated manner to arrest tax evasion by prosecution (*paragraph 3.12*).
- Therefore, ITD did not apply penalty as per provisions of the Act effectively. ITD has also not given adequate priority to the prosecution in tackling tax evasion and prosecution mechanism is not working effectively and efficiently.